owned facilities.[103] VNJ, by contrast, currently serves some 4.34-million residential lines.[104] On this basis, VNJ controls fully 98.64% of the New Jersey residential local exchange service market. Thus, in any given year (and assuming that the churn rate and market share remain constant), Verizon NJ will have the opportunity to "address" 16.8% (i.e., 17% household relocation rate x 98.64% residential market share) of all residential customers in Verizon NJ's service area as a result of *customer-initiated* "inbound" contacts alone.

81. The model assumes that in approximately 82.4% of such customer-initiated contacts in which an order for new local service is placed, the customer selects Verizon Long Distance as the PIC following the "recommendation" of the VNJ service representative.[105] 28.9% of American households have at least two residential access lines,[106] and (assuming that the same relocation rate applies to these households as to the population generally) it is likely that

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103. Bone (Verizon NJ), Declaration, Attachment 101, Table 1.

104. 2000 ARMIS Report 43-08, Table 3.

105. This 82.4% Verizon Long Distance "take rate" for "inbound" local service customers was developed as follows: Verizon Long Distance claims to have captured a 20% share of the New York market in the first year in which its entry was allowed. "Verizon Communications Posts Strong Results for Fourth Quarter and 2000," Verizon News Release, February 1, 2001. On average, about 30% of residence customers change their PIC in any given year. "J.D. Powers and Associates Reports: Sprint and SNET Top Performers in Residential Long Distance Customer Satisfaction," July 29, 1999. Thus, 6% (20% of 30%) out of Verizon's 20% total long distance market share is attributable to PIC changes made by existing customers. The remaining 14% would then be attributable to inbound local service customers selecting Verizon Long Distance at the time that they placed their orders for local service. Since the overall residential relocation rate is 17%, I have estimated the "take rate" at 14%/17%, or 82.4%.

106. FCC, *Trends in Telephone Service*, August 2001, Table 8.4.

a customer with an additional line will select the same long distance carrier for both the primary line and the additional line.[107]

82. Offsetting these "captures" of customers by Verizon NJ/Verizon LD are the ongoing marketing efforts of the other IXCs. In 1999, approximately 30% of all US residential customers changed their PIC.[108] Extrapolating this to New Jersey, the model assumes that each year 30% of the customers who had Verizon NJ long distance service at the beginning of the year will switch to another IXC (which I assume to occur at mid-year, on average) sometime during the year. However, Verizon will also be marketing its long distance service to customers of other IXCs, and so the model also assumes that Verizon will capture a portion of those customers' PIC changes as well. Specifically, the model uses Verizon's long distance market share at the beginning of each year to determine what proportion of all non-Verizon PIC changes will be captured by Verizon during that year (with the exception of year 1, in which the 20% end-of-year share captured by Verizon in New York is used).

107. In fact, as discussed above, the FCC has ruled that where the contact is initiated by an *existing* BOC customer (e.g., to order an additional line or to add vertical service features), the BOC *will not be required* to offer to read the list of available IXCs. *AT&T/BA-NY Order*, at para. 15. As a result, it is likely that the customer's propensity to selected the BOC's Long Distance affiliate as the PIC would be even higher for additional lines than for the primary line, where the BOC is required to offer to read the list of IXCs. Since the model assumes the *same* "take rate" for both primary and additional lines, it likely errs on the conservative side.

108. J.D. Powers report, *op. cit.*, footnote 105.

83. Scenario 1 in Attachment 4 provides the results of this model, and demonstrates that if the current Verizon NJ *local service* market share of 98.64% is maintained throughout the five-year period covered by the model, at the end of that time Verizon Long Distance will have captured some 71% of all New Jersey residential subscribers in Verizon NJ's service territory.

84. In Scenario 2 in Attachment 4, I have changed the original assumption regarding Verizon NJ's share of the local market. Rather than holding it constant at the current 98.64% level, I have assumed that it will fall by 3% annually through the fifth year. All else remaining the same as per the original (page 1) model, this erosion in Verizon NJ's local market share (down to 84% at the end of the fifth year) will still provide Verizon NJ with a 66% share of the residential long distance market as of the end of the study period.

85. In Scenario 3 in Attachment 4, I have modeled the case where CLECs are even more successful (than in the Scenario 2 model) in capturing *local* customers. Here, I have assumed that CLECs capture 10% of residential customers in the initial year following Section 271 approval, and have assumed additional annual CLEC market share growth at half of the initial year rate for each of the next four years. At the end of the fifth year, Verizon NJ's local market share would then be 69%, but its long distance market share will still be larger than that for any IXC today, at 59%.

86. While the model attempts to address certain market dynamics, it does not consider all of them. For one, it assumes that all of the existing non-BOC IXCs remain in business during the entire period, i.e., that despite the persistent expansion of the BOC's share of the long distance market, the other carriers continue to remain profitable and continue to maintain the same type of market *and marketing* presence that they do today. The recent and precipitous decline in the value of IXC stocks would, however, suggest that Wall Street expects otherwise. Massive IXC market share losses over a short period of time are likely to result in one or more of the major IXCs exiting the market, an outcome that would be almost certain to further increase Verizon's ultimate market share.

87. There are strong parallels between the various policy initiatives taken during the 1980s that were designed to open the long distance market to entry by "Other Common Carriers" ("OCCs," defined as interexchange carriers other than AT&T) and the current policy moves toward authorizing BOC entry into the long distance market. In the earlier case, OCC entry and growth were facilitated by several factors, including the requirement that BOCs (and later extended to ILECs generally) provide "equal access" and associated dialing parity to all IXCs.[109] The current analogy to "equal access" is the Section 271(c)(2)(B) 14-point

109. Others include (a) the requirement that *discounted* access charges apply to OCCs prior to the introduction of equal access in any central office, (b) "balloting" of BOC customers with respect to the choice of PIC and *assignment* of nonresponding BOC customers to OCCs in proportion to the selections made by responding customers, (c) adoption of an "equal charge per minute of use" rule, which deprived AT&T of any opportunity to benefit with respect to access charges paid to ILECs from its size, incumbency or scale economies relative to those of its smaller rivals, and (d) adoption of the so-called "five-mile rule," under
(continued...)

"Competitive Checklist." The remaining policy initiatives were expressly intended to jump-start long distance competition, to give the OCCs certain specific opportunities to expand their market that would overcome the enormous obstacles confronting any non-incumbent attempting to enter a market long dominated by a single firm.

88. The transition to equal access began in 1985 and was substantially complete by the end of 1988. The 1985 beginning of the transition to equal access is analogous to the initial satisfaction of the 14-point checklist. By the end of the fifth year (i.e., by the end of 1990), the non-AT&T IXCs had acquired 24.4% of presubscribed lines nationwide. As I have discussed, the model I have constructed predicts BOC shares (also in terms of presubscribed lines) in the range of 71% to 59% at the end of the fifth year following BOC long distance entry).

89. In view of the strong parallels between OCC entry in the 1980s and BOC entry today, I believe that the *results* of the earlier policy paradigm offer a useful and reasonable standard against which the current policy initiatives relative to BOC entry can be evaluated. In order to facilitate this examination, I have used the model to estimate the share of the *local*

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109. (...continued)
which all OCCs locating their points of presence ("POPs") within five miles of an ILEC access tandem would be subject to the same access charges as would AT&T (which was often collocated with the BOC), thereby eliminating any incumbency and preexisting collocation advantages that might otherwise have benefitted AT&T. AT&T was also subject to a disproportionately-applied "equal access recovery charge," forcing it to pay a relatively larger share of the costs of implementing equal access than its OCC rivals.

market that CLECs would have to acquire over the five-year period in order to limit the BOC *long distance* market share to the same 24.4% of presubscribed lines that the OCCs were able to acquire as of five years following the initiation of equal access. As Scenario 4 in Attachment 4 indicates, the CLEC market share that would be required to achieve this outcome is 21.25% as of the beginning of year 2 and through to the end of year 5. In view of the fact that by Verizon NJ's own account CLECs currently have only a 1.3% local service market share, it is virtually *inconceivable* that CLECs could achieve a local service penetration rate of 78.75% or anything remotely close to it over the coming five-year period.

90. From the foregoing discussion and analysis, it is evident that the development of effective competition for *local* services is critical to forestall remonopolization of the long distance market following Verizon NJ entry. As long as VNJ is permitted to exploit its captive relationship with the vast majority of local service customers to market and sell its affiliate VLD's long distance services, VNJ/VLD long distance shares will grow rapidly and non-BOC IXCs will suffer a precipitous decline in customers and demand. Faced with such losses, IXC costs will rise and at least some IXCs will be forced to exit the business, further exacerbating the situation and affording the BOCs an even greater opportunity to remonopolize the nation's long distance market. Therefore, before recommending approval of Verizon's filing for Section 271 authorization by the FCC, this Board has the authority and obligation to implement all measures that it believes necessary under both federal and New Jersey law to ensure full competition in the intrastate interLATA market.

As a prerequisite to any recommendation to the FCC on Verizon's Section 271 filing, the Board must require full structural separation of Verizon's wholesale and retail entities.

91. In addition to the Board's consideration of Verizon NJ's compliance with the checklist items of Section 271(c)(2)(B), the Board must consider additional principles to protect ratepayers from the potential for a speedy remonopolization by Verizon of the interLATA long distance market. The Board may impose specific requirements for long distance entry on VNJ and/or on VLD to assure that the interests of New Jersey consumers and competitors are protected. One such requirement should be structural separation of the Verizon NJ retail and wholesale (network) operations.

92. The New Jersey legislature and this Board have long been concerned with the impacts upon ratepayers and upon competition arising from transactions and other interactions between a regulated utility and its nonregulated affiliates. In previous Board investigations into affiliate transactions and corporate structures, the Board has based its determination on the grounds that the action "will not negatively impact competition, will not negatively impact the rates of current customers, will not negatively impact employees, and will not negatively impact the provision of safe, adequate and proper service."[110] These standards require that in no event may ratepayers be made worse off as a result of the affiliate relationship than in its absence. The Board should consider this public interest standard when evaluating Verizon New Jersey's application, and implement any necessary remedies to address these concerns.

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110. *RCN Order.*

93. The New Jersey legislature has expressly contemplated in the *New Jersey Electric Discount and Energy Competition Act* ("EDECA") that regulated utilities must be accountable to a code of conduct in dealing with their affiliates and, to prevent any self-dealing in violation of the public interest, the Board last year adopted a specific code of conduct to govern such intracorporate relationships for electric and natural gas utilities in the state:

> ... an electric or gas public utility shall not:
>
> 1. Provide leads to its PUHC or a related competitive business segment of its public utility holding company;
>
> 2. Solicit business on behalf of its PUHC or a related competitive business segment of its public utility holding company;
>
> 3. Acquire information on behalf of or to provide to its PUHC or a related competitive business segment of its public utility holding company;
>
> 4. Share market analysis reports or any other types(s) of proprietary or non-publicly available reports, including but not limited to, market, forecast, planning or strategic reports, with its PUHC or a related competitive business segment of its public utility holding company;
>
> 5. Share customer usage or end use equipment information obtained during the course of providing electric and/or gas public utility services, including but not limited to the administration of demand-side management programs, with its PUHC or a related competitive business segment of its public utility holding company;
>
> 6. Request authorization from its customers to pass on customer information exclusively to its PUHC or a related competitive business segment of its public utility holding company;
>
> 7. Represent or imply that the electric and/or gas public utility speaks on behalf of its PUHC or related competitive business segment of its public utility holding company or that the customer will receive preferential

treatment as a consequence of conducting business with the related competitive business segment of its public utility holding company.

8. Represent or imply that its PUHC or a related competitive business segment of its public utility holding company speaks on behalf of the electric and/or gas public utility.[111]

The EDECA recognizes the significant risk to competition posed by self-dealing and discriminatory conduct as between a regulated utility and a nonregulated affiliate, and the Board, in its promulgation of rules and regulations, has taken affirmative steps to limit the exercise of a utility's market power. Telecommunications companies, like electric and gas companies, as a direct result of their status as former monopoly utilities, receive hundreds or thousands of incoming calls per day from customers either ordering new service or with respect to the customers' existing service. The utilities enjoy name recognition because every household in the utility's service area receives a monthly bill with the utility's name and logo and, because the utility's rates have traditionally been regulated, customers have an expectation that the prices for the utility's services are reasonable.

94. The specific difficulty in addressing and in preventing this type of cross-subsidization has also been addressed in the past by other state commissions. For example, the California legislature has enacted a set of conditions that a BOC must satisfy as a precondition for PUC approval of its Section 271 application that address the same types of public interest, cross-subsidization, and competitive safeguards that are addressed in the New

111. N.J.A.C. 14:4-5.3(m).

Jersey Telecommunications Act as well as in EDECA. These conditions, set out at Section 709.2(c) of the California Public Utility Code, offer a useful set of guidelines that the Board should consider in evaluating Verizon New Jersey's Application:

> No commission order authorizing or directing competition in intrastate interexchange telecommunications shall be implemented until the commission has done all of the following, pursuant to the public hearing process:
>
> (1) Determined that all competitors have fair, nondiscriminatory, and mutually open access to exchanges currently subject to the modified final judgment and interexchange facilities, including fair unbundling of exchange facilities, as prescribed in the commission's Open Access and Network Architecture Development Proceeding (I. 93-04-003 and R. 93-04-003).
>
> (2) Determined that there is no anticompetitive behavior by the local exchange telephone corporation, including unfair use of subscriber information or unfair use of customer contacts generated by the local exchange telephone corporation's provision of local exchange telephone service.
>
> (3) Determined that there is no improper cross-subsidization of intrastate interexchange telecommunications service by requiring separate accounting records to allocate costs for the provision of intrastate interexchange telecommunications service and examining the methodology of allocating those costs.
>
> (4) Determined that there is no substantial possibility of harm to the competitive intrastate interexchange telecommunications markets.

Thus, in developing its consultative recommendation to the FCC, the Board:

(1) should determine that all competitors have fair, nondiscriminatory, and mutually open access to all Verizon New Jersey exchanges, including fair unbundling of exchange facilities;

(2) should determine that there is no anticompetitive behavior by Verizon New Jersey, including unfair use of subscriber information or unfair use of customer contacts generated by Verizon New Jersey's provision of local exchange telephone service;

(3) should determine that there is no improper cross-subsidization of Verizon's intrastate interexchange telecommunications service by requiring separate accounting records to allocate costs for the provision of intrastate interexchange telecommunications service and examining the methodology of allocating those costs; and

(4) should determine that there is no substantial possibility of harm to the competitive intrastate interexchange telecommunications markets arising from Verizon's entry therein.

95. These four principles actually mirror the standards embodied in New Jersey public utility legislation. Principle (1) mirrors the requirements of N.J.S.A. 48:2-21.19(e)(1); principle (2) is similar to requirements in N.J.A.C. 14:4-5.3(m)(1) and 14:4-5.3(m)(2);

principle (3) is found in N.J.S.A. 48:2-21.18(c); principle (4) restates the policy of the State as recognized in 48:2-21.16(a)(4).

96. An additional case also occurred in the late 1980s, and involved the marketing of an affiliate's long distance service by an independent LEC in Ohio.[112] In its decision in that matter, the Public Utilities Commission of Ohio recognized the anticompetitive and cross-subsidization implications of such an arrangement, and directed that the provision and marketing of local and long distance services by carried out by structurally separate affiliates. The Board concluded:

> After thoroughly reviewing all of the testimony and exhibits in this matter, the Commission finds that the close affiliation between UTLD [United Telephone Long Distance] and its parent company UTO [United Telephone of Ohio] creates a potential for cross-subsidization and anti-competitive practices to occur between the two companies, which would be detrimental to the customers of UTO and, therefore, is not in the public interest. However, the Commission believes that, by requiring UTLD and UTO to maintain operations that are structurally separate, the potential for these detrimental practices to occur will be minimized, if not eliminated. Therefore, the Commission concludes that UTLD's application for authority to furnish intrastate interexchange telecommunication services ... should be granted, contingent upon UTLD's and UTO's compliance with the conditions set forth below.
>
> UTLD contends that the use of common operational and managerial resources between UTO and UTLD is beneficial not only to UTLD, but to UTO's customers as well, for a number of reasons one of which is the ability of UTO to spread some of its fixed costs to UTLD. However, the Commission

112. *In the Matter of the Application of United Telephone Long Distance, Inc. for Authority to Furnish Interexchange Telecommunications Services Within the State of Ohio*, Public Utilities Commission of Ohio, Case No. 86-2173-TP-ACE, *Summary of Finding and Order*, December 23, 1988.

> believes that the potential for abuse of this type of structure, especially between two regulated utilities, one of which is an LEC with a monopoly position in its franchised service area, far outweighs any nominal benefits which may or may not ever the realized by either company and their customers. In order to ensure against abuse of UTO's and UTLD's affiliation, it is essential that the two companies operate as totally separate and independent entities. To accomplish this, UTLD and UTO must employ separate directors, officers, and personnel. ... UTO must not share its technical resources and equipment, including, but not limited to, office furniture, data systems, central office equipment and space, and other facilities, with UTLD, unless such resources and equipment are also made available to other IXCs under like conditions.[113]

This Board should similarly consider rules that require structurally separate affiliates coupled with strong self-enforcing sanctions regarding affiliate transactions in the event that Verizon New Jersey receives Section 271 authority at this time.

97. As both a wholesale provider of essential facilities to interexchange carriers (access services) and CLECs (bundled wholesale services, Unbundled Network Elements, and various interconnection arrangements for the interchange of traffic) as well as a *retail* provider of these services competing directly with the very same interexchange and competitive local exchange carriers, Verizon NJ has both strong financial incentives and extensive opportunities to engage in a pattern of conduct that is directly inconsistent with the explicit requirements of the Nondiscrimination Safeguards of section 272(c)(1). Such conduct, which is extremely difficult to detect except through after-the-fact complaints, works to undermine the potential for local service competition at its most fundamental level and has the potential to undermine the robust competition that presently exists in the interLATA long distance market.

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113. *Id.*, at 37-38.

98. The extent to which Verizon NJ may be engaging in one or more forms of anticompetitive conduct can only be accurately assessed in terms of actual marketplace *results* rather than by an examination of individual incidents. Intense competition has developed in virtually every segment of the US telecommunications industry in which the RBOCs do not maintain some form of bottleneck control over essential facilities, either because such control has been expressly prohibited by legislative, judicial or regulatory fiat, or in which the RBOCs have themselves had minimal involvement (e.g., and at least up to now, dial-up access to the Internet). On the other hand, where RBOCs have been permitted to engage in retail operations in markets in which they also control essential facilities (e.g., local exchange service), competition has failed to develop.

99. Structural separation of those portions of Verizon NJ's operations that provide essential network resources to competing retail services from those portions of Verizon NJ's operations that are themselves involved in the retail provision of service to end user customers would prevent such anticompetitive conduct. Under structural separation, Verizon NJ-retail would be required to deal with Verizon NJ-wholesale in exactly the same manner and under the same terms, conditions, and operational interfaces as its nonaffiliated retail competitors. Structural separation of the Verizon New Jersey retail and long distance services is expressly required by the Act.

100. It will not be possible for the Board to assure that all of the specific competitive protections that are required by the New Jersey and federal statutes are being satisfied on a

continuing basis following Verizon NJ's entry into the in-region interLATA long distance business *so long as Verizon NJ is permitted to pursue its retail local and long distance business and underlying network operations on an integrated basis.* Only through full structural separation,[114] in which Verizon NJ's retail organization is required to acquire the underlying network services from a separated Verizon NJ wholesale entity on the same terms and conditions and by means of the same interfaces as its nonaffiliated retail competitors, can the Board make the affirmative determinations that it is required to do under the federal and state statutes.

The Public Interest Standard of the federal Act requires that the Board implement a strict Code of Conduct to prevent violations of the federal and state prohibitions against cross-subsidization, as well as the remonopolization of the long distance market, before the Board can issue a recommendation regarding Verizon's 271 Application to the FCC.

101. It may be possible to achieve the goal of full parity without requiring the creation of separate wholesale and retail VNJ entities, but only where a strict and effective code of conduct is in place and is subject to effective and rigorous monitoring by the Board. However, I must emphasize that the competitive benefits of formal structural separation cannot be understated. The most effective approach would clearly be outright divestiture and full separation of the monopoly and competitive business units — the method that was adopted and successfully applied when the former Bell System was split into separate local

114. I have addressed the issue of structural separation of Verizon NJ's monopoly wholesale network functions from its competitive retail activities more fully in testimony submitted in BPU Docket TO01020095 on August 3, 2001.

and long distance corporations. The formation of separate operating companies within the Verizon corporate structure offers the benefit of relatively simple and straightforward monitoring, but in the end is still subject to capital, personnel and other resource allocation decisions that will be made at the parent company level, presumably with the goal of maximizing joint profits rather than specifically aimed at achieving true parity. This is best seen by the Verizon's continued practice of sharing employees between its local and long distance affiliates, despite the structural separation requirements of section 272.

102. An alternative approach was adopted recently by the Pennsylvania Public Utility Commission ("PA PUC")[115] as a modification to a previous ruling that had called for the formation of separate Verizon wholesale and retail corporate entities.[116] Described as "functional/structural separation," the PA PUC's approach does not require that separate corporate units be formed, but instead imposes strict accounting safeguards and a strict "code of conduct" that would govern the interactions between Verizon-Pennsylvania's wholesale network operations and its retail operations. The code of conduct that would apply for the functional/structural separation regime is in the process of being formulated.[117]

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115. *Re: Structural Separation of Bell Atlantic–Pennsylvania, Inc. Retail and Wholesale Operation*, M-00001353 (April 11, 2001).

116. *Joint Petition of Nextlink Pennsylvania, Inc. et. al., P-00991648, Joint Petition of Bell Atlantic-Pennsylvania, Inc.*, P-00991649 (September 30, 1999) ("*Global Order*").

117. "The Code of Conduct rulemaking record shall be re-opened for the purpose of receiving comments and reply comments on the appropriate Code of Conduct to be applied *in light of this Commission's determination in the instant proceeding*. This shall be done on an (continued...)

103. Because functional/structural separation does not involve the creation of separate wholesale and retail corporate entities, the explicit *inter-company* transactions that would have been recorded on each corporation's books of accounts under formal structural separation would be replaced by *intra-company* transactions that would ordinarily be far more difficult for the Commission to monitor and audit. The PA PUC expressly recognized that "the concept of virtual structural separation involves implementing rules in accounting and operations, as well as regulations that effect a substantial separation, albeit virtual, of Verizon's wholesale and retail local exchange businesses."[118]

104. At the present time, there is no existing accounting treatment to recognize and record intracompany transfers between "Verizon's wholesale and retail local exchange businesses." Under formal structural separation, VNJ-retail as well as all nonaffiliated CLECs would be required to make *cash payments* to VNJ-wholesale for all services furnished by the wholesale entity. Under the type of functional/structural separation envisioned by the Pennsylvania PUC, currently unrecorded transfers of services and resources from VNJ's network business units to its retail organization would need to be recognized and offsetting "payment" entries would need to be made. Separate cash books would need to be maintained so as to prevent the VNJ retail operations from trading on the wholesale organization's cash

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117. (...continued) expedited basis. Until completion of the final rulemaking in the Competitive Safeguards Proceeding, we expect Verizon to fully comply with the interim Code of Conduct set forth in the *Global Order*." April 11, 2001 *Opinion and Order*, at 35, emphasis supplied.

118. *Id.*, at 30.

position and working capital. Allocations of all jointly-used resources between the two organizational units would also need to be made, and nonaffiliated CLECs would need to be afforded access to those same resources at the same prices that are recorded for intra-VNJ transfers. Moreover, in order to assure that VNJ does not deliberately *overcharge* its retail business units for such transfers and allocations, a process would need to be established to assure that all such accounting entries reflect actual costs. There are also no specific existing rules requiring accounting entries be made to reflect the value of any preferential treatment, such as the direct on-line access to electronic customer account and billing data and the "warm transfer" of an inbound call from a VNJ exchange service customer to Verizon Online or (after Section 271 authority is received) to Verizon Long Distance.[119] Indeed, due to the utter lack of any financial tracking of the costs of the "wholesale" services that Verizon's retail operation provides to its retail end user customers, new accounting devices will need to be created so that the Board can determine that the competitive VNJ retail activity is profitable and is not being cross-subsidized by the monopoly wholesale organization. CLECs are forced by the discipline of cold, hard cash to operate within the margin between their own retail price (which is necessarily dictated by VNJ's retail price) and the prices they pay to VNJ for the "wholesale" services the CLECs then furnish to their retail customers. Absent

119. I believe and recommend that such "warm transfers" to nonregulated Verizon affiliates of inbound calls placed to VNJ be strictly prohibited, together with all other aspects of such "joint marketing" of monopoly and competitive services. Nevertheless, if VNJ is allowed to engage in these kinds of activities, VNJ should be compensated by the affiliates for the full market value of such referrals, with such compensation being flowed through to VNJ monopoly service ratepayers (including IXC and CLEC customers of access services and UNEs) as exogenous cost changes in accordance with the price cap rate adjustment mechanism, or through some other means.

the type of accounting safeguards envisioned by the Pennsylvania PUC, Verizon's retail operations confront no comparable disciplines or constraints.

105. We really don't have any experience with the type of "functional" or "virtual" structural separation that the Pennsylvania PUC has adopted. Existing accounting rules, structures and practices in use by VNJ are simply not designed to capture the kinds of intra-company transactions that would produce a parity condition relative to the *cash transactions* that surround *all* transactions between VNJ and nonaffiliated CLECs. Some of these problems might be addressed through a code of conduct (for example, by preventing a retail customer service representative from calling her friend in the Outside Plant department to clear up a problem, requiring instead that the same formal processes to which CLECs are subjected be utilized), but many transfers of value will likely go unrecorded and unrecognized. The effect of such unrecorded transfers is, of course, a *de facto* cross-subsidy for the benefit of VNJ's retail operations, a benefit that would be unavailable to nonaffiliated CLECs. Even with respect to recorded transactions, the Board will need assurance that these are fair and cost-based, and are not being "rigged" so as to create an excessive "price" for sales of services to nonaffiliated CLECs.

106. Moreover, if a less-than-formal structural separation approach is adopted by the Board, it is nevertheless critical that CLECs be afforded equal and nondiscriminatory access to the same resources, in the same manner, and in the same time frame as VNJ provides to its own retail operation. It is unreasonable to expect competition to succeed if VNJ persists in

treating its competitors as mere retail customers who happen to be purchasing relatively large quantities of services and/or certain services (UNEs) that *end user* retail customers normally don't. Functional/structural separation must financially track all transactions between VNJ's retail and wholesale divisions just as would be the case for transactions between VNJ and nonaffiliated competitors. And VNJ's retail division must not be afforded "back door" access to the Company's network systems and functions while nonaffiliated competitors are forced to "wait in line" at the "customer service counter." If the Board can accomplish these goals through functional/structural separation, the goal of achieving a competitive local telecommunications market in New Jersey may yet materialize. But, as the Pennsylvania Commission has itself recognized,[120] functional/structural separation under which Verizon is permitted to operate its network (wholesale) and retail activities under the same corporate umbrella will necessarily require far more regulatory oversight than would be necessary under formal structural separation. Strengthening the Code of Conduct to capture these additional requirements and safeguards thus becomes a critically important step.

107. I recommend that the Board focus upon *objectives* rather than on *process*, that it pursue a solution that will best achieve the overarching goal of establishing an effectively competitive local telecommunications market in New Jersey. If the Board determines that it can realize this goal through something short of formal structural separation of VNJ's wholesale and retail business units *and is prepared to accept the additional regulatory burdens and responsibilities that this approach will necessarily entail*, the Board could

120. Pennsylvania PUC *Global Order*, at 231.

certainly attempt to proceed in this manner. However, in so doing the Board should put VNJ on notice that it will expect nothing less than the same market outcome that would arise under formal structural separation, and that if this does not materialize within a set time frame (certainly not longer than twelve months from the date of the Board's Order), formal structural separation will follow.

108. The Board should consider applying a code of conduct similar to that promulgated pursuant to EDECA, and which I cited earlier at paragraph 93. The same potential for abuses of market power by the incumbent utility, as recognized in the *Electric Discount and Energy Competition Act*, are even more likely to arise in the local and long distance telecommunications market once Verizon is allowed to offer long distance service to its New Jersey customers. If the FCC grants Verizon NJ Section 271 authority, the Board should adopt and enforce limitations such as those imposed by EDECA on energy companies. Adoption by the Board of a more stringent code of conduct applicable to the VNJ/VLD provision of *intrastate* interLATA services would not be in conflict with the joint marketing that is permitted under the Act.

Conclusion

109. In considering the Verizon New Jersey Section 271 Application and in making its consultative recommendation to the FCC, the Board should recognize that the failure of meaningful and effective competition to develop in the New Jersey local services market despite years of regulatory attention and billions of dollars of investment may well be due

largely to the insurmountable barriers that perpetuation of the existing integrated Verizon New Jersey have created. Whatever solution the Board may ultimately adopt with respect to structural separation, code of conduct, or other remedial measures, it should keep the overarching goal of a competitive local telecommunications market squarely at the center of its policy focus.

110. Given the persistently slow pace at which local competition in New Jersey has been able to develop under the existing *integrated* operation of Verizon New Jersey, together with the enormous marketing advantages that Verizon New Jersey and Verizon Long Distance will acquire in selling its long distance services to what are essentially captive residential and small business subscribers, allowing Verizon New Jersey into the long distance market at this time is decidedly inconsistent with the public interest. Verizon New Jersey can and, as the experience in New York amply confirms, will use its dominance of the local market to preemptively sell its long distance services to inbound customers, and even with minimal marketing and advertising generally can be expected to rapidly increase its share of the New Jersey long distance market to the point of substantial market dominance. Rather than increasing competition in long distance services as the Company contends will arise as a result of its entry, market concentration will grow, competition will suffer, and prices to consumers will inevitably rise.

Before the

STATE OF NEW JERSEY
BOARD OF PUBLIC UTILITIES

In the Matter of the Application of Verizon New Jersey, Inc. for FCC Authorization to Provide In-Region, InterLATA Service in New Jersey	Docket No. TO01090541

COMMONWEALTH OF MASSACHUSETTS)
) ss.
COUNTY OF SUFFOLK)

AFFIDAVIT OF LEE L. SELWYN

LEE L. SELWYN, of lawful age, certifies as follows:

1. I am President of Economics and Technology (ETI), Two Center Plaza, Suite 400, Boston, Massachusetts 02108. I am authorized to verify the statements contained in the foregoing Declaration, prepared on behalf of the Division of Ratepayer Advocate.

2. The foregoing Declaration was prepared based upon my review of the testimony being proffered by Verizon New Jersey ("VNJ" or "Company") in support of its Application for authority, pursuant to Section 271 of the *Telecommunications Act of 1996* ("TA96" or "Act"), to enter the in-region long distance market in New Jersey, and various other pertinent documents. The statements made in the foregoing Declaration are true and correct to the best of my knowledge, information and belief.

3. In the event that additional responses to interrogatories propounded to Verizon NJ become available, I am reserving the right to file supplemental testimony, should that be required.

I certify that the foregoing statements made by me are true to the best of my knowledge, information and belief. I am aware that if any of the foregoing statements made by me are willfully false, I am subject to punishment.

Lee L. Selwyn

Subscribed and sworn to before me this 22nd day of October, 2001.

Ellen B Wasserman
Notary Public

My commission expires 3/31/06.

Attachment 1:

Statement of Qualifications